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THE WHITE HOUSE
WASHINGTON

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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 3/14/84 Number: 168939CA Due By: _____Subject: Cabinet Council on Economic Affairs - March 15, 1984

TOPICS: Pending Tax Legislation

8:45 a.m. - Roosevelt Room

Pension Policy

ALL CABINET MEMBERS	Action	FYI		Action	FYI
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Attorney General	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Baker	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Darman (For WH Staffing)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HHS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Jenkins	<input type="checkbox"/>	<input checked="" type="checkbox"/>
HUD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	McFarlane	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	Svahn	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Energy	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Education	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Counsellor	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
UN	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	CCCT/Gunn	<input type="checkbox"/>	<input type="checkbox"/>
EPA	<input type="checkbox"/>	<input type="checkbox"/>	CCEA/Porter	<input checked="" type="checkbox"/>	<input type="checkbox"/>
OPM	<input type="checkbox"/>	<input type="checkbox"/>	CCFA/	<input type="checkbox"/>	<input type="checkbox"/>
VA	<input type="checkbox"/>	<input type="checkbox"/>	CCHR/Simmons	<input type="checkbox"/>	<input type="checkbox"/>
SBA	<input type="checkbox"/>	<input type="checkbox"/>	CCLP/Uhlmann	<input type="checkbox"/>	<input type="checkbox"/>
			CCMA/Bledsoe	<input type="checkbox"/>	<input type="checkbox"/>
			CCNRE/	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

The Cabinet Council on Economic Affairs will meet on Thursday, March 15, 1984, at 8:45 a.m. in the Roosevelt Room.

The agenda and background paper are attached.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

☐ Katherine Anderson
☒ Tom Gibson

Associate Director
Office of Cabinet Affairs

☐ Don Clarey
☐ Larry Herbolzheimer

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THE WHITE HOUSE

WASHINGTON

March 14, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER *EM fu*

SUBJECT: Agenda and Papers for the March 15 Meeting

The agenda and papers for the March 15 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The first agenda item is a report on pending tax legislation. A memorandum prepared by Assistant Secretary Chapoton describing the House Ways and Means Committee substitute to H.R. 4170 and the tentative Senate Finance Committee decisions is attached.

The second agenda item is a report from the Working Group on Pension Policy. In recent years, a number of companies have recovered surplus assets from their defined pension plans after terminating the plans and purchasing annuity contracts to provide all accrued benefits. The Working Group reviews several legislative proposals for restricting reversions and offers an alternative Administration policy. A memorandum from the Working Group is attached.

THE WHITE HOUSE
WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

March 15, 1984

8:45 a.m.

Roosevelt Room

AGENDA

1. Pending Tax Legislation (CM # 417)
2. Report of the Working Group on Pension Policy
(CM # 112)



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MAR 13 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

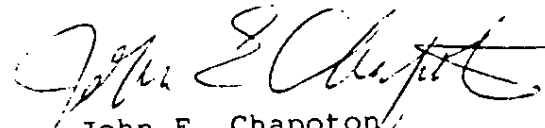
Subject: Pending Tax Legislation

On March 1, the House Ways and Means Committee agreed to a committee amendment to be offered as a substitute to H.R. 4170, the bill the Committee had reported out last October but that the House had not considered prior to adjournment. Many of the tax proposals in the Administration's budget have been incorporated in the Committee's bill. As amended, we estimate that H.R. 4170 would raise \$45.5 billion for fiscal years 1985 through 1987 (\$47.0 billion for 1984-1987).

The House Rules Committee on March 7 adopted what amounts to a closed rule for floor consideration of the bill. Ways and Means Chairman Rostenkowski has indicated that he does not want the bill considered until after the House adopts a budget resolution, which he hopes will be by the end of March. Should this resolution call for greater revenue increases than the Committee already has adopted, the Chairman anticipates fashioning a floor amendment in Committee containing additional revenue measures.

The Senate Finance Committee is close to completing its work on a deficit reduction package coupling spending cuts within the Committee's jurisdiction with revenue increases. We estimate that Committee action to date would increase revenue by \$46.9 billion for fiscal years 1985 through 1987 (\$49.5 billion for 1984-87). Again, many of the tax proposals in our budget have been included.

Summaries of H.R. 4170 and the Senate Finance Committee tentative decisions to date are attached, with accompanying revenue tables.


John E. Chapoton
Assistant Secretary
(Tax Policy)

Attachments

H.R. 4170
AS ADOPTED BY THE HOUSE WAYS AND MEANS COMMITTEE
March 1, 1984

I. Provisions Reported October 21, 1983

Leasing to Tax Exempts. The bill denies certain tax benefits to limit the use of sale-leaseback transactions and similar arrangements by State and local governments, private nonprofit organizations and certain foreign persons.

Life Insurance. The bill replaces the existing system of taxing life insurance companies with simpler, more rational rules for determining the taxable income of these entities.

Private Foundations. The bill makes a number of changes to liberalize the current rules governing private foundations.

Tax Simplification. The bill contains a number of technical, simplifying and generally noncontroversial changes to the Internal Revenue Code, including more rational rules for taxing divorce settlements, changes in the estimated tax deposit and tax credit ordering rules, and several administrative provisions sought by the Treasury Department.

Fringe Benefits. The bill provides specific statutory authority for excluding a wide variety of commonly provided fringe benefits from the income of recipients. This change is motivated by the Ways and Means Committee's desire not to extend beyond 1983 the legislative moratorium on the issuance of Treasury regulations relating to the taxation of fringe benefits.

Technical Corrections. This title of the bill makes technical revisions to the Tax Equity and Fiscal Responsibility Act of 1982, the Subchapter S Revision Act of 1982, the Highway Revenue Act of 1982, the Social Security Amendments of 1983, and other related legislation.

Tax-Exempt Bonds. The bill extends the tax exemption for interest on State and local government bonds issued to finance single family housing ("mortgage subsidy bonds"), allowing mortgage subsidy bonds to be issued through 1988. This program expired at the end of 1983. The bill also permits State and local governments to elect to exchange all or part of their mortgage subsidy bond authority for authority to issue mortgage credit certificates entitling homeowners to nonrefundable income tax credits that offset

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home mortgage interest costs. The Administration has strongly opposed the extension of the mortgage subsidy bond program, although it has supported the more efficient mortgage credit certificate approach as an option if the mortgage subsidy bond program is extended over the Administration's objections.

The bill also imposes a number of additional limitations on private purpose tax-exempt bonds, including industrial development bonds, similar to those contained in the Administration's budget. Key features impose state volume caps, stronger arbitrage rules, and limits on the tax exemption for certain Federally-guaranteed obligations.

Miscellaneous Revenue Measures. The bill contains provisions to grant capital gain treatment for gains on conversion of apartment buildings to condominiums, liberalizes the disaster loss deduction, limits certain tax straddle abuses and provides tax qualification for certain money purchase pension plans. In addition, the bill contains items approved by the Committee in November, including an extension of existing rules for net operating loss carryovers in corporate acquisitions, an extension of special tax treatment for certain payments under the PIK program, an exclusion from income for tuition reductions granted to graduate teaching assistants, and a series of private relief measures.

II. Miscellaneous Technical Changes

The Committee adopted a number of technical changes to the foregoing provisions, including clarifications to provide an additional exception to the volume cap for certain "public purpose" IDBs, and to expand the category of Federal guarantees which may be combined with tax-exempt financing to include FNMA, FHLMC, GNMA, SLMA, and certain SBA guarantees.

III. Effective Dates

A number of effective date provisions were extended, although a motion by the Chairman to extend the effective date of the IDB volume cap for one year to January 1, 1985, was tabled by voice vote.

IV. Additional Revenue Provisions

A. Tax Freeze Items

Foreign Earned Income. The maximum amount of excludable income earned abroad would remain at \$80,000 until 1988, then increase in \$5,000 increments to

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\$95,000 in 1990. Under ERTA, the exclusion is \$85,000 in 1984, rising in \$5,000 increments to \$95,000 in 1986.

Expensing. The amount of personal property businesses may elect to expense is frozen at \$5,000 through 1987, going to \$7,500 in 1988 and 1989, and \$10,000 thereafter (instead of going to \$7,500 in 1984 and 1985 and to \$10,000 thereafter).

Investment Credit for Used Property. The maximum amount of used property eligible for the credit is frozen at \$125,000 until 1988, when it will increase to \$150,000. Under ERTA, this increase occurs in 1985.

Net interest exclusion. The 15 percent net interest exclusion scheduled to begin after 1984 is repealed.

Pension plan indexing. The indexing for inflation of dollar limits on contributions to and benefits from qualified pension plans scheduled to begin in 1986 will be delayed until 1988.

ESOPs. The tax credit for employer contributions to employee stock ownership plans will be frozen at one-half of one percent until 1988 (it was scheduled to go to three-fourths of one percent in 1985).

Estate and Gift Tax Rate. The top 60 percent rate will remain until 1987, going to 55 percent in 1988 and 50 percent thereafter. Under ERTA the rate is scheduled to go to 55 percent in 1984 and 50 percent thereafter.

Windfall profit tax. The bill freezes the windfall profit tax rate on newly discovered oil at 25 percent through 1987, reducing it to 22.5 percent for 1988, 20 percent for 1989, and 15 percent thereafter. Under ERTA the rate declines to 22.5 percent in 1984, 20 percent in 1985, and 15 percent thereafter. The bill corrects technical errors with respect to depletion on secondary and tertiary production.

Excise tax on cigarettes and distilled spirits. The cigarette excise tax scheduled to go from 16 to 8 cents per pack after September 30, 1985, will go to 12 cents per pack until January 1, 1988, and for 1986 and 1987 the present \$10.50 per proof gallon tax on distilled spirits will increase by somewhat less than \$3.50 per gallon.

Telephone excise tax. The telephone tax scheduled to expire after 1985 will be extended until 1988.

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Finance leasing. The effect of the finance lease rules adopted in TEFRA will be postponed from March 1, 1984 until 1988. A moratorium is imposed through 1987 on the issuance of Treasury regulations distinguishing leases from conditional sales or other financing arrangements. The Treasury Department strongly opposes these provisions.

B. Tax Shelter, Corporate Reforms, and Accounting Abuses

Partnership provisions. The bill contains the provisions in the Administration's budget dealing with partnership allocations, contributions of property to partnerships, and like-kind exchanges of partnership interests. The Committee added rules limiting the use of tiered partnerships to avoid income characterization rules and limiting elective basis adjustments.

Other pass-through entities. Short-term loss treatment will be denied for losses on mutual fund shares held for 6 months or less. Multiple trusts having the same grantor and substantially the same beneficiaries will be consolidated if established with a principal purpose of tax avoidance. Trust distribution rules will be modified to tax certain asset appreciation.

Corporate reforms. The allowable dividends received deduction will be reduced for dividends with respect to certain debt-financed portfolio stock. Certain extraordinary dividends received by corporations will reduce the basis of stock held for less than 1 year.

The use of regulated investment companies by corporate investors to pass through interest income will be limited. Broker reporting rules will be amended to insure reporting to corporate customers of certain short sale transactions.

Ordinary, non-liquidating distributions of appreciated property (including the distribution of interests in a royalty trust) will be taxed to the distributing corporation as if the property had been sold, subject to a special small business exception.

The bill clarifies that the mere fact that a company is widely held does not exempt it from the accumulated earnings tax. Also, the net capital loss deduction will be denied for mere investment or holding companies.

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In the case of a short sale of stock, payments in lieu of dividends will not be deductible against ordinary income unless the short sale is held open for at least 16 days. No deduction will be allowed for payments in lieu of extraordinary dividends unless the short sale is held open for at least 1 year. The disallowed amounts will be treated as part of the basis of the short seller in the stock acquired to close the short sale.

A corporate distribution or a liquidating sale of a partnership interest will be treated as a transfer of the distributing corporation's allocable share of certain recapture items held by the partnership. The amount of income recognized will be limited to the gain the corporation would have recognized had it sold the partnership interest.

A corporation dealing in its own stock warrants will recognize neither gain nor loss.

Nonrecognition of gain when a corporation buys back its debt by issuing stock will be limited to insolvent or bankrupt corporations.

The earnings and profit rules will be amended where a corporation distributes discount debt obligations to its shareholders.

The definition of affiliated group for purposes of consolidated returns will be tightened.

Foreign Items. The rules governing transfers of appreciated property abroad will be amended to provide for recognition of gain unless the property is transferred for use in an active trade or business.

Rules relating to the taxation of deferred income of controlled foreign corporations will be strengthened to curtail transactions in which a U.S. corporation may be acquired by a related controlled foreign corporation for the purpose of escaping U.S. tax liability.

Recharacterization of U.S. income as foreign source income to circumvent the foreign tax credit limitation will be limited. Certain foreign dividends will be treated as interest for purposes of the separate foreign tax credit limitation for interest income.

The use of the Territories to avoid U.S. tax will be limited.

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Certain shipping income will be U.S.-source income.

U.S. shareholders will be taxed at ordinary income rates on dispositions of foreign collapsible corporations.

Accounting Abuses. The bill contains the Administration's proposals relating to deferred payments, premature accruals, prepaid expenses, deferred like-kind exchanges (with the 90-day period extended to the earlier of 180 days or the due date for the return), and LIFO conformity.

Recharacterization of interest-free loans will be required along the lines the Administration had proposed, with the interest rate imputed at the Treasury bill rate.

Bonds and other debt instruments. The use of market discount instruments to convert ordinary income to capital gain will be limited by deferral of interest deductions allocable to indebtedness incurred to purchase or carry such obligations, and by requiring that gain on disposition be recognized as interest income to the extent of accrued market discount. Neither rule will apply where the holder elects to include accrued market discount in income currently.

Original issue discount on zero coupon municipal bonds will be accrued, and the holder's basis adjusted, under an economic accrual formula.

Rules covering leveraged purchases of short-term discount obligations will be changed to defer interest deductions, and rules relating to acquisition discount on Treasury bills will be changed to account for acquisition discount on the accrual basis.

Tax benefit inclusion. Where a taxpayer recovers a previously-deducted amount (such as a State tax refund), the amount will be excluded from gross income only to the extent that it did not reduce income subject to tax in the prior year.

Income averaging. The current 120-percent threshold by which current taxable income exceeds average income over the prior 4 years to allow income averaging will be raised to 140 percent, and only the 3 prior years will be taken into account. The impact of averaging on tax brackets will be modified.

Factoring trade receivables. Certain income from foreign factoring subsidiaries of U.S. corporations will be taxed to the U.S. owner.

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Compliance. The bill requires tax shelter promoters to keep lists of their investors for audit purposes. The penalty for promoting abusive tax shelters is increased. The Treasury Department is given authority to regulate appraisers. Reporting will be required for certain foreclosures, mortgage interest, sales or exchanges of partnership interests, and IRA contributions. The burden of reporting of State income tax refunds will be eased.

C. Employer-Employee Provisions

Welfare benefit plans. Deductions will be limited based on benefits provided during the year to prevent unreasonable accumulations of funds. Reserves will be allowed for certain insurance-type benefits. Rules relating to deductions for vacation pay will be tightened.

Permissible benefits provided under Voluntary Employees' Beneficiary Associations (VEBAs) will be limited to excluded deferred compensation. Unrelated business income rules applicable to VEBAs will be tightened, and the application of nondiscrimination rules clarified.

The distinction between deferred compensation and welfare benefits will be clarified.

Management unions. Organizations consisting primarily of owners, officers, or executives of the employer will be prevented from using exclusions to the nondiscrimination rules designed for collective bargaining units.

Employee contribution plans. Favorable rules for qualified pension plans will be denied to plans under which all contributions are made by employees.

Cash-or-deferred arrangements. In testing these arrangements for discrimination, employer Social Security contributions will be excluded.

D. Miscellaneous Items

Transfers of depreciable property between related parties. Gain recognized on the transfer of a patent application will be treated as ordinary income.

Collapsible corporations. As the Administration has proposed, the ordinary income that must be recognized on sale or liquidation of a corporation to avoid the collapsible corporation sanctions will be increased.

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Puerto Rican and Virgin Islands excise taxes. The bill will limit the circumstances in which revenues from excise tax on redistilled and cane neutral spirits are "covered over" to Puerto Rico and the Virgin Islands. Revenue will be capped at \$130 million for the period July 1, 1983, through June 30, 1984, and \$75 million from July 1, 1984, through June 30, 1985. This change is an outlay reduction rather than a revenue item.

Luxury autos. The basis for investment tax credit and cost recovery purposes of automobiles used for business will be limited to \$21,000. In addition, taxpayers will have to overcome a rebuttable presumption that one-half of all automobile use is for personal rather than business purposes.

Tips as FUTA wages. Tips will be included as wages for purposes of the Federal Unemployment Tax Act.

Pension rules. Certain top-heavy plan rules will be modified to reduce their impact on airline pilots.

RICs. Essentially technical aspects of the tax treatment of regulated investment companies will be modified.

Cooking wine. Excise taxes will not be paid on distilled spirits used in cooking wines.

Estate taxes. The rules permitting installment payments of estate taxes attributable to closely-held businesses will be modified.

Dependent care organizations. As the Administration has proposed, not-for-profit dependent care organizations will be treated as tax exempt.

E. Stock Option Straddles

As the Administration has proposed, stock options (and stock where offset by an option) will be subject to existing loss deferral rules, except for straddles all of the legs of which are stocks. However, professional options traders will be taxed under a mark-to-market system at a maximum tax rate of 32 percent.

Special rules are provided for hedging transactions. Options on regulated futures contracts, options on broad-based stock indexes, and all nonequity-based listed options will be taxed under a mark-to-market system at a maximum 32-percent rate.

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IV. Highway Use Taxes

The bill modifies the heavy vehicle use tax adopted in the Surface Transportation Act of 1982, and increases the highway diesel fuel tax from 9 to 14.5 cents per gallon, effective July 1, 1984. Owners of vehicles under 10,000 pounds may claim a one-time rebate of a standardized amount for the life of the vehicle on their income tax returns.

March 13, 1984

SENATE FINANCE COMMITTEE

TENTATIVE DECISIONS

Summarized below are the tax provisions and those spending provisions involving the Treasury Department that were tentatively adopted by the Senate Finance Committee in mark-up activity on February 28, February 29, March 1, March 7, and March 8. These provisions are in addition to those tax provisions contained in the Omnibus Reconciliation Act of 1983 listed in the first portion of the attached table of revenue estimates.

The Finance Committee will continue deliberations today.

I. Administration Budget Proposals

A. Tax Shelter Provisions

Partnership allocations. The Committee adopted the Administration's proposals intended to prevent retroactive allocations of partnership items.

The Committee agreed to prohibit allocations of partnership income that result in the equivalent of current deductions for expenditures that otherwise would be capitalized.

The Committee agreed to treat a contribution of property to a partnership followed by a distribution to the contributing partner as if the property were sold by the contributing partner to the other partners or, where appropriate, as a part sale and part contribution of property.

The Committee agreed to amend the allocation rules to prevent the shifting of income and loss with respect to contributed property. Built-in losses on contributed capital assets would retain their capital loss character for five years, and contributed property that constituted inventory in the hands of the contributing partner would retain its ordinary income character for five years.

Charitable contributions. The Committee agreed to increase, from 50 percent to 60 percent of the donor's adjusted gross income, the limitation on the deduction for cash contributions by an individual to public charities or to private operating foundations. Also, the carryover of excess charitable contributions would be extended from 5 years to 15 years.

The Committee also agreed to a number of requirements relating to appraisals and information reporting that would have to be met in order for a donor to obtain a charitable deduction for the fair market value of appreciated property, other than publicly traded securities. This part of the proposal differs from the Administration's original proposal but is supported by Treasury. In addition, the Committee agreed to modifications to the penalty with respect to over-valuations.

Like-kind exchanges. The Committee agreed to require that tax-free like-kind exchanges be completed by the earlier of the date that is 180 days after the first transfer of property or the due date of the taxpayer's income tax return for the year of the first transfer of property. The proposal would also require that the property to be received in the exchange be designated at the time the taxpayer transfers the property.

Market discount on bonds. The Committee agreed to require gain on disposition of a bond to be taxed as interest income to the extent of accrued market discount.

Interest on indebtedness incurred to purchase or carry market discount bonds or short-term discount obligations. The Committee agreed to defer interest deductions on indebtedness incurred to purchase or carry market discount bonds or short-term obligations issued at an acquisition discount. A transitional rule not contained in the Administration's proposal would be provided under which taxpayers could pay any resulting tax liability over a five-year period, with interest.

B. Accounting Abuses

Treatment of interest attributable to deferred payments. The Committee agreed to extend the original issue discount rules to sales of property and services, subject to an appropriate de minimis rule and exceptions for certain sales of farms and principal residences. Interest on deferred payment sales would be required to be calculated on an economic basis. In sales transactions where interest is charged at less than 110 percent of the rate for Treasury debt of a comparable maturity, interest would be imputed at a rate equal to 120 percent of the comparable Treasury rate.

Prepayment of expenses. The Committee adopted limitations on prepayments of expenses that are quite different from those proposed by the Administration. Under the Committee's provision, deductions for prepayments of expenses would be allowed only if they do not exceed a taxpayer's investment (excluding any investment made with borrowed funds) and are made for a business purpose. In addition, no deduction would be allowed for interest on indebtedness incurred to make such prepayments. The Committee also agreed that this rule would be drafted so as to be at least as stringent as present law.

Interest-free and low-interest loans. The Committee agreed to treat interest-free and low-interest loans for income and gift tax purposes as if interest were actually charged and paid at the rate for Treasury debt of a comparable maturity, and as if the lender rebated the interest to the borrower. The rules would apply to loans between family members, corporations and their shareholders, and persons providing services and persons for whom the services are provided. De minimis rules would be provided.

Related-party transactions. The Committee agreed to limit the ability of accrual basis taxpayers to deduct interest with respect to amounts owed to a related cash basis person until the interest is actually paid. Unlike the Administration's proposal, however, an exception will apply for certain low-income housing resyndications.

Preserving the LIFO conformity rule. The Committee agreed to prohibit a subsidiary corporation from electing the LIFO method of inventory accounting unless its parent corporation uses the LIFO method for book purposes (with an exception for foreign parents of U.S. subsidiaries).

Premature accruals. The Committee agreed to prevent taxpayers from deducting accrued liabilities until economic performance has occurred. Unlike the Administration's proposal, however, exceptions will apply for mining reclamation and closing costs and for nuclear power plant decommissioning expenses.

C. Corporate Reforms

Denial of interest deduction for leveraged stock investments by corporations The Committee agreed to disallow interest deductions on debt incurred by a corporation that would not have been incurred but for an investment in stock. The disallowed interest deductions will be equal to the dividends received deduction for dividends on the leveraged stock.

Expenses incurred in connection with short sales. The Committee agreed that, in the case of a short sale of stock, payments in lieu of dividends would not be deductible against ordinary income unless the short sale is held open for at least 16 days. No deduction would be allowed for payments in lieu of extraordinary dividends unless the short sale is held open for at least one year. The disallowed amounts would be treated as part of the basis of the short seller in the stock acquired to close the short sale.

Receipt of extraordinary dividends by corporations. The Committee agreed to require a corporate shareholder that does not hold stock for at least one year to reduce the basis in its stock by the fair market value of any extraordinary dividend (to the

- extent not subject to tax). A corporate shareholder's holding period for property received as a dividend could not exceed its holding period for its stock in the distributing corporation.

Transfers of partnership interests by corporations. The Committee agreed to require that a corporate distribution or a liquidating sale of a partnership interest be treated as a transfer of the distributing corporation's allocable share of certain recapture items held by the partnership. The amount of income recognized would be limited to the gain the corporation would have recognized had it sold the partnership interest.

Widely-held corporations and the accumulated earnings tax. The Committee agreed to clarify that a company is not exempt from the accumulated earnings tax merely because its stock is widely held. Also, the net capital loss deduction would be denied for mere holding or investment companies.

Capital gain dividends from mutual funds. The Committee agreed to require that any loss recognized on the sale or exchange of RIC or REIT stock held for six months or less be treated as long-term capital loss to the extent that distributions to the shareholder with respect to the stock were treated as long-term capital gain.

Taxation of transfers of certain assets to foreign corporations. The Committee agreed to require gain to be recognized upon the transfer of appreciated property to a foreign corporation if the transfer has the effect of tax avoidance and is not for use in an active trade or business outside the U.S. An automatic toll charge would be imposed on transfers of certain tainted assets with the exception of transfers of stock. Also, intangibles could no longer be transferred abroad free of tax.

Decontrol of controlled foreign corporations. The Committee agreed to treat certain acquisitions by a controlled foreign corporation of stock of a U.S. shareholder in exchange for stock of the controlled foreign corporation as a transfer of controlled foreign corporation stock by the U.S. shareholder.

Foreign sales corporations. The Committee adopted the Administration proposal to replace the DISC with a foreign sales corporation through which export sales may be made. Special rules were provided for export trading companies, and the Committee expanded the small business exception.

D. Other.

Income tax exemption for U.S. military and civilian government personnel killed from overseas injuries. The Committee agreed that, if a member of the U.S. Armed Forces or a civilian employee of the United States dies while in active service from wounds or injuries incurred after 1979 as a result of a terroristic or military action outside the U.S., no U.S. income tax will be imposed on the individual's income beginning with the year preceding the year in which the wounds or injuries were received.

PIK. The Committee agreed to extend the tax provisions relating to the Payment-in-Kind program to 1984 spring wheat.

Tax-exempt status for nonprofit dependent care facilities. The Committee agreed that a dependent care facility will be treated as a section 501(c)(3) organization, and thus receive tax-exempt status and be eligible to receive tax-deductible contributions, if (1) the organization is operated to provide nonresidential care; (2) substantially all of the dependent care is provided to enable individuals to be gainfully employed; and (3) the services provided by the organization are available to the general public.

Treat taxable alimony as compensation for IRA purposes. Taxable alimony received during a year would be treated as compensation for purposes of applying the IRA deduction limits without the conditions and limitations of present law.

II. Freeze Items

Telephone excise tax. The Committee agreed to extend the three-percent telephone excise tax through 1987.

Election to expense certain depreciable assets. The Committee agreed to defer for four years the scheduled increases in the cost of certain property that may be expensed in the year it is placed in service. Thus, the present \$5,000 limit would be maintained through 1987.

Investment credit for used property. The Committee agreed to defer for four years the scheduled increase from \$125,000 to \$150,000 in the cost of used property eligible for the investment tax credit.

Exclusion of foreign earned income. The Committee agreed to defer for four years the scheduled increases in the amount of foreign earned income that a taxpayer may exclude from gross income.

III. Grace Commission Proposals

Repeal tax exemption for FHLMC. The Committee agreed that the Federal Home Loan Mortgage Corporation will lose its tax exempt status for taxable years beginning after 1984.

Debt offsets. The Committee agreed to have the Internal Revenue Service offset delinquent nontax debts owed to the Federal Government against tax refunds. This provision was adopted over the Commissioner's objections, for a two-year period beginning January 1, 1986.

Income verification. Subject to Treasury's developing safeguards, the Committee agreed that the Internal Revenue Service will make available data on unearned income to Federal and State agencies administering means-tested Federal benefit programs. This information would be used to verify eligibility for the benefit programs.

Cash management. The Committee agreed that the Federal Government will be required to accelerate the deposit and collection of nontax receipts through various cash management techniques. Treasury is to file a report concerning problems arising out of this proposal.

IV. Other Tax Proposals

A. Corporate

Payments in lieu of dividends. The Committee agreed to amend reporting requirements to ensure that corporate lenders of stock will not claim any dividends received deduction with respect to payments in lieu of dividends received by them from the borrowers of stock.

Dividends from mutual funds. The Committee agreed to increase from 75 to 95 percent the portion of gross income constituting dividend income that a RIC must have before all its dividend payments can be treated as dividend income by corporate shareholders.

Warrants. The Committee agreed to extend the current rule that a corporation does not recognize gain or loss on transactions in its own stock to transactions involving warrants to acquire its own stock. This rule would apply to warrants that lapse or are retired after the date of enactment.

Dividends of OID obligations. The Committee agreed that a corporation's earnings and profits should be reduced by the fair market value, rather than by the face amount, of its own debt obligations distributed as a dividend. Furthermore, interest would accrue on such obligations under the original issue discount rules.

Non-divisive "D" reorganizations. The Committee agreed that, in order to stop certain abusive liquidations and reincorporations, the definition of "control" for purposes of the non-divisive "D" reorganization provisions should be reduced from 80% to 50%.

"C" reorganizations. The Committee agreed that transferor corporations must liquidate in order for a transfer of their assets to qualify under the "C" reorganization provisions.

Appreciated property. The Committee adopted a rule generally making ordinary nonliquidating distributions of appreciated property (such as interests in a royalty trust) taxable to the distributing corporation.

Net operating losses. The Committee delayed until December 31, 1985 the effective date for the limitations on net operating losses added by the Tax Reform Act of 1976. For transactions involving reorganizations in bankruptcy, however, the Tax Reform Act of 1976 provisions would be effective for transactions between January 1, 1984 and the date of Committee action; for such transactions beginning after the date of committee action, the provisions applicable before the 1976 Act would apply.

Tax treatment of regulated investment companies. The Committee adopted a proposal under which a personal holding company may qualify as a RIC, and a RIC may elect to accrue original issue discount on short-term obligations. The proposal makes clear that tax-exempt interest remains tax-exempt when distributed to RIC shareholders.

B. Foreign.

Shipping income. The Committee determined that certain income earned from transportation that begins and ends in the U.S. (or U.S. possessions) should be treated as U.S.-source income, even where the route lies outside the U.S. territorial limit.

Recharacterization of U.S. income. The Committee adopted a provision that limits the conversion of U.S.-source income into foreign-source income by taxpayers attempting to increase foreign tax credits, and limits the conversion of interest income into dividend income.

Coordination of foreign personal holding company rules and subpart F. The Committee determined that same country dividends will be excluded from the foreign personal holding company provisions. In addition, the coordination between subpart F and the foreign personal holding company rules would be clarified by giving subpart F priority. Finally, it would be made clear that the foreign personal holding company rules could not be avoided by insertion of an entity between a U.S. shareholder and a foreign personal holding company.

C. Compensation.

Nonstatutory fringe benefits. The moratorium on the issuance of fringe benefits regulations would be extended for two additional years, through December 31, 1985. The freeze would apply to faculty housing where the professor pays the cost of the housing.

Employee educational assistance. The income tax exclusion for benefits under employer-provided educational assistance programs would be extended for two additional years, through December 31, 1985, and the rule of the Greensboro Pathology Associates case concerning employer deductions for pre-funding educational benefit trusts would be reversed.

Multiemployer pension plan withdrawal liability. The general effective date provided in the Multiemployer Pension Plan Amendments Act for employer liability to a multiemployer pension plan upon withdrawal from a plan would be changed to September 26, 1980 (date of enactment of the MPPAA).

Rollover to IRAs. The Committee agreed that relief would be granted for certain pension plan distributions received during 1976 and 1977 and transferred to individual retirement accounts. Under the proposal, the transfers would be treated as tax-free rollovers.

Technical correction of FICA and FUTA exemption for certain state retirement plan contributions. A technical correction to the Social Security Amendments of 1983 would be provided to ensure that employer payments of employee contributions under a State or local retirement plan that is a pick-up plan (under section 414(h)) are subject to FICA and FUTA only if the payments are made pursuant to a salary reduction arrangement.

FUTA treatment of fisherman. Fishing boat crew members who are treated as self-employed for purposes of income tax withholding and social security tax would be treated as self-employed and therefore not subject to tax for purposes of the Federal Unemployment Tax Act. (Crew members generally are treated as self-employed if their remuneration is a share of the catch and if the crew of each boat normally is made up of fewer than ten individuals.)

State pension plans--required distributions. The effective date of the TEFRA changes relating to distributions from a qualified pension plan would be delayed to December 31, 1986, for a plan maintained by a State.

Unemployment compensation for pre-1978 periods. The Revenue Act of 1978 would be amended to provide that certain provisions of that statute, which make includible in income a portion of unemployment compensation benefits, apply to payments of unemployment compensation made after 1978 except payments for weeks of unemployment ending before December 1, 1978. The period for claiming any credit or refund attributable to this amendment would also be extended until one year after enactment.

Pension portability. Individuals who were employees of AT&T before the split-up would be entitled to credit for pension purposes for past service to AT&T.

Social Security for congressional employees. The amendment, which was previously approved by the Committee, would require that an individual in Congressional employment maintain continuous participation in the Civil Service Retirement System (CSRS) in order to retain an exemption from social security.

Technicals to tip reporting. The Committee modified the TEFRA tip reporting requirements (1) to allow a majority of the employees of a restaurant to demonstrate that their average tip is below eight percent, (2) to allow tips to be proved down to two percent rather than present law five percent; and (3) to require the IRS to issue guidelines on reporting and recordkeeping requirements for tipped employees.

D. Real Estate.

Section 167(k) extention. The Committee agreed to extend for three years, through 1986, the rule permitting rehabilitation expenditures with respect to low-income housing to be amortized over 60 months.

Demolition of historic structures. The Committee agreed that the disallowance of income tax deductions for costs of demolition of certified historic structures will be reinstated and made permanent. A current deduction for the costs of demolition of other structures would be denied. Instead, the costs would be included in the basis of the land, or, where appropriate, the basis of a new structure on that land.

Architectural and transportation barrier removal expenses. The Committee adopted a proposal under which the deduction of up to \$35,000 per year for expenses incurred in eliminating architectural and transportation barriers to the handicapped would be reinstated for two years to apply to expenses incurred in taxable years beginning in 1984 and 1985.

Rehabilitation tax credit. The Committee determined to extend the rehabilitation tax credit for older buildings to cases where the following criteria are met: (1) at least 50 percent of the building's external walls are retained as external walls; (2) at least 75 percent of the building's external walls are retained as either internal or external walls; and (3) at least 75 percent of the building's internal structural framework is retained.

Cooperative housing corporations. Under the proposal adopted by the Committee, all persons would be allowed to qualify as tenant-stockholders of cooperative housing corporations, and certain persons would be treated as entitled to occupy their cooperative units even if the cooperative housing corporation retains the right to disapprove occupancy. Tenant-stockholders of a cooperative housing corporation who use units in a trade or business would not be allowed to deduct rental payments to the extent such payments are attributable to amounts paid or incurred by the corporation that are required to be capitalized.

E. Miscellaneous

Distilled spirits excise tax. The Committee agreed that after June 30, 1984, payments to Puerto Rico or the Virgin Islands with respect to distilled spirits would be limited to articles comprised of at least 92 percent rum.

During the period from July 1, 1983, through June 30, 1984, total payments with respect to articles containing distilled spirits (other than distilled spirits that are at least 92 percent originally distilled in Puerto Rico) would be limited to a maximum of \$130 million.

During the transition period from date of Committee action through July 1, 1984, if Puerto Rico makes any incentive

payment (directly or indirectly) to a U.S. distiller (other than reimbursement for direct costs of transportation to and from Puerto Rico) with respect to distilled spirits not meeting the original distillation test, payments of excise tax revenues to the possession with respect to redistilled spirits would immediately terminate.

Tax benefit rule. The Committee agreed that if State taxes and other itemized deductions previously deducted are refunded to or recovered by a taxpayer, the portion of the deduction that produced a tax benefit is to be presumed to be recovered. This corrects a defect in the current rules.

Payment method for certain excise taxes. The Committee agreed to require excise taxes on alcohol and tobacco products to be paid, and returns filed, 14 days after the close of each semi-monthly period. In addition, the Committee agreed to require taxpayers who were liable for more than \$5 million in such taxes in the preceding year to pay the excise taxes by electronic funds transfer to a Federal Reserve Bank.

Reciprocal leases. The Committee agreed that where a taxpayer is both a lessor and a lessee of similar property, he will be denied ACRS deductions and investment tax credits for the property he leases to others. This provision is intended to prevent the use of reciprocal lease or "tax swap" arrangements under which taxpayers seek to convert personal use property into business use property.

Dual purpose assets. The Committee adopted a proposal to deny ACRS benefits (or full deductions for lease payments) for property if it is not used at least 50 percent for business. Property used less than 50 percent for business would be depreciated using a less favorable method. ACRS taken on property that ceases to meet the 50-percent threshold within an extended recovery period would be subject to recapture.

Modifications to section 1231. The Committee agreed to modify the tax rules governing gains and losses on property used in a trade or business. Under the modification, gains and losses on such property would continue to be netted against each other, with net gains treated as long-term capital gains and net losses treated as ordinary losses. However, the period for netting gains and losses would be extended to three prior taxable years and three succeeding years, to prevent manipulation of the netting rules by taxpayers timing the realization of gains and losses to occur in alternate years. The extension of the netting period beyond the current year would not apply to gains and losses realized as a result of involuntary conversions.

Luxury autos. Depreciation and investment tax credits with respect to most automobiles would be computed at cost only up to \$15,000 (indexed for inflation). The proposal would apply to property placed in service after March 1, 1984.

Minimum tax. The Committee adopted, subject to additional clarification, an expansion of the alternative minimum tax for individuals. Under this proposal, a taxpayer's losses from passive investments attributable to nonrecourse borrowing would become an additional item of tax preference to the extent those losses exceed the taxpayer's income from passive investments.

Trust provisions. The Committee adopted provisions limiting the use of multiple trusts and modifying trust distribution rules with respect to appreciated property.

Finance leasing. The Committee agreed, over Treasury's objection, that the finance lease rules adopted in TEFRA will be postponed until 1988.

Pre-opening expenditures. The Committee adopted a provision under which pre-opening or start-up expenditures will be amortized over 5 years.

Sound recordings. Under the Committee proposal, non-ACRS property will receive no more favorable treatment than ACRS property. Thus a taxpayer claiming a six percent investment tax credit may not claim depreciation faster than that allowed for 3-year property.

Reporting of State tax refunds. The requirement imposed by the Tax Equity and Fiscal Responsibility Act relating to reporting of State tax refunds would be modified to provide that information returns to be given to taxpayers may be provided with refund checks for refunds after 1982. A State would be subject to the penalty for failure to provide an information return.

Estate tax installment payments. The Committee adopted a proposal that would amend the estate tax installment payment provisions to permit consideration of the value of certain active business stock owned indirectly through a passive holding company in determining whether an estate qualifies for installment payments. The special four percent interest rate and five-year deferral of principal payments would not apply to estates electing this provision.

Exemption from aviation excise tax for certain helicopter operations. The present exemption from the airways fuels and passenger ticket taxes for helicopters engaged in timber operations and hard mineral exploration, and not using the ADAP system, would be extended to helicopters engaged in oil and gas exploration.

Abatement of penalties--contest award (Roseann York). In the case of an individual who won a home designed for her handicapped foster son in a radio contest, penalties would be abated and collection activities would be deferred for six months after the date of enactment, to permit the taxpayer to arrange for payment of the underlying tax liability.

Special estate tax credits--estates of Nell Redfield and Elizabeth Rabe. A special credit against Federal estate tax would be allowed on the estates of Nell J. Redfield and Elizabeth Schultz Rabe.

Wildlife refuge system. Issuing of the symbol appearing on duck stamps would be permitted for a fee that would be paid into the Migratory Wildlife Fund.

Estate and gift tax marital deduction--technical amendment. The Committee agreed to make clear that a usufruct interest is treated as a qualified income interest for life that may qualify for the marital deduction.

Make permanent the Tribal Indian Tax Status Act. The Tribal Indian Tax Status Act, which expires after 1984, treats Tribal governments as State governments for purposes of the Internal Revenue Code (but without authority to issue industrial development bonds). The Committee proposal would make the Act permanent.

Exemption of certain sewage and solid waste disposal facilities from the limitation on small bond issues. Under a Committee proposal, capital expenditures for solid waste disposal facilities that produce energy will not be included for purposes of computing the \$10 million limit on small issue IDBs.

V. Treasury Report on Regulated Futures Contracts Litigation.

The Committee agreed to require the Secretary of Treasury to report to the Senate Committee on Finance and House Committee on Ways and Means by October 1, 1984, on progress made by the Internal Revenue Service in reducing the backlog of cases involving the tax treatment of certain regulated futures contracts prior to the straddle rules adopted in ERTA.

Office of Tax Legislative Counsel

U.S. TREASURY DEPARTMENT

Approved For Release 2008/08/20 : CIA-RDP86M00886R002000010009-3
Revenue Effect of the Tax Reform Act of 1984 as Passed by the Ways and Means Committee
(March 12, 10:00 a.m.)

(\$millions)							
	Fiscal years						Total
	: 1984	: 1985	: 1986	: 1987	: 1988	: 1989	: 1985-1987
I. H.R. 4170 (amended) as reported:							
A. Tax-exempt entity leasing.....	682	990	1,741	3,069	4,877	6,978	5,800
B: Life insurance tax provisions							
Company taxation and life insurance products.....	-597	-1,029	-1,137	-1,243	-1,336	-1,441	-3,409
Nondeductible IRAs.....	-15	-66	-141	-227	-321	-423	-434
Total, life insurance tax provisions.....	-612	-1,095	-1,278	-1,470	-1,657	-1,864	-3,843
C. Private foundations.....	-14	-45	-46	-47	-50	-53	-138
D. Simplification:							
Estimated tax rules for individuals:							
Changes in exceptions from penalty, allow penalty waiver, measure penalty from exception amounts..	--	135	-51	-58	-67	-77	26
Require estimated tax payments of alternative minimum tax.....	--	611	45	49	52	56	705
Subtotal, estimated tax rules.....	--	746	-6	-9	-15	-21	731
Domestic relations.....	--	-8	-53	-19	16	29	-80
At risk rules for losses.....	*	*	*	*	*	*	*
Estate tax provisions.....	--	10	10	10	10	10	30
Foreign tax provisions:							
Definition of resident aliens.....	--	5	7	7	8	8	19
Community property income--nonresident aliens....	--	1	3	3	3	3	7
Foreign personal holding companies.....	--	*	*	*	*	*	*
Coordination of subpart F with foreign personal holding company provisions.....	--	1	3	3	3	3	7
Stapled stock.....	--	1	3	3	3	3	7
Subtotal, foreign tax provisions....	--	8	16	16	17	17	40
Miscellaneous Treasury administrative provisions....	*	*	*	*	*	*	*
Tax Court provisions.....	--	--	--	--	--	--	--
Simplification of income tax credits.....	121	220	206	205	113	26	631

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(\$millions)

	Fiscal years						Total
	1984	1985	1986	1987	1988	1989	1985-1987
Miscellaneous tax provisions:							
Rollover of certain partial distributions from qualified plans.....	-*	-*	-*	-*	-*	-*	-*
Treatment of certain related party transactions...	50	114	185	264	350	433	563
Preferred stock eligible for small business corporation treatment.....	-*	-*	-*	-*	-*	-*	-*
Medical expense deduction for certain lodging.....	-1	-7	-10	-10	-11	-11	-27
Subtotal, miscellaneous provisions..	49	107	175	254	339	422	536
Total, simplification.....	170	1,083	348	457	480	483	1,888
E. Fringe benefits provisions:							
Tuition reduction for graduate study.....	-4	-16	-35	-42	-45	-48	-93
Other.....	-*	-*	-*	-*	-*	-*	-*
Total, fringe benefit provisions....	-4	-16	-35	-42	-45	-48	-93
P. Technical corrections.....	-8	-*	-*	-*	-*	-*	-*
G. Tax exempt bonds:							
Mortgage subsidy bonds and credit certificates.....	-40	-185	-396	-615	-841	-841	-1,196
Industrial development bonds.....	27	123	305	487	580	644	915
Total, tax exempt bonds.....	-13	-62	-91	-128	-261	-197	-281
H. Miscellaneous:							
Capital gains treatment for portion of gain on condominium conversions.....	-33	-72	-71	-53	-29	-18	-196
No gain recognized from net gifts made before March 4, 1981.....	-*	-*	-*	-*	-*	-*	-*
Disaster loss deduction.....	-15	-12	-12	-13	-13	-13	-37
Tax straddles--avoidance of accumulated earnings tax through use of foreign corporations.....	*	*	*	*	*	*	*
Exclusion of certain education expenses.....	-*	-*	-*	-*	-*	-*	-*
Money purchase pension plans.....	-*	-*	-*	-*	-*	-*	-*
Total, miscellaneous.....	-48	-84	-83	-66	-42	-31	-233
Total, H.R. 4170 (amended) as reported.....	153	771	556	1,773	3,302	5,268	3,100

Revenue Effect of the Tax Reform Act of 1984 as Passed by the Ways and Means Committee
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(\$millions)

	Fiscal years						Total
	1984	1985	1986	1987	1988	1989	1985-1987
II. Additional Revenue Provisions Adopted:							
A. Tax Freeze:							
Foreign earned income exclusion--freeze at \$80,000 to 1988, increase by \$5,000 annually thru 1990..	4	11	20	26	22	14	57
Limit expensing (under ACRS) to \$5,000 thru 1987, \$7,500 in 1988-89, \$10,000 thereafter.....	202	348	366	278	-166	-537	992
Investment credit for used property--	--	49	104	115	87	31	268
\$125,000 thru 1988.....	--	920	2,874	3,152	3,467	3,813	6,946
Repeal net interest exclusion.....	--	--	17	64	106	116	81
Limits on pension plans frozen until 1988.....	--	365	727	925	625	332	2,017
ESOP's.....	--	--	--	--	--	--	--
Top estate and gift tax rate--60% thru 1987, 55% in 1988, 50% thereafter.....	--	129	399	503	578	439	1,031
Windfall profit tax on newly discovered oil--	--	--	--	--	--	--	--
25% thru 1987, 22.5% in 1988, 20% in 1989, 15% thereafter.....	26	39	26	-2	*	*	63
Percentage depletion for secondary and tertiary oil and gas by independents.....	-184	-259	-244	-233	-277	-226	-736
Cigarette and alcohol excise taxes	--	125	1,773	1,915	835	49	3,813
Telephone excise tax expiration delayed to 1988...	--	--	1,168	2,016	803	--	3,184
Finance leasing--to 1988.....	63	351	875	1,404	1,445	739	2,630
Subtotal, tax freeze.....	111	2,078	8,105	10,163	7,525	4,740	20,346
B. Partnerships and other pass-through entities:							
Use of allocations to affect income or loss:	4	61	147	178	240	298	386
Contributed property.....	--	50	75	100	100	100	225
Partnership losses.....	--	--	--	--	--	--	--
Conversion or deferral of income:	*	24	63	66	67	69	153
Gain or loss on contributed property.....	--	--	--	--	--	--	--
Organizational fees and other capital expenditures.....	--	20	51	60	69	78	131
Disguised sales.....	*	*	*	*	*	*	*
Tiered partnerships.....	*	34	94	100	118	126	228
Like-kind exchanges of partnership interests.....	--	--	83	89	96	103	172
Transactions in mutual fund shares.....	--	23	29	27	26	21	79
Multiple trusts.....	50	214	361	409	438	467	984
Trusts distributions.....	--	--	--	--	--	--	--
Subtotal, partnerships.....	54	426	903	1,029	1,154	1,262	2,358
C. Taxation of corporations and their shareholders:							
Dividends received by corporations:	*	90	180	200	300	300	470
Debt-financed portfolio stock.....	*	140	100	100	100	100	340
Extraordinary dividends.....	*	*	*	*	*	*	*
Dividends received from RIC's.....	--	--	--	--	--	--	--
Dividends received deduction--compliance.....	--	--	--	--	--	--	--

Revenue Effect of the Tax Reform Act of 1984 as Passed by the Ways and Means Committee
(March 12, 10:00 a.m.)

(\$millions)

	Fiscal years						Total
	: 1984	: 1985	: 1986	: 1987	: 1988	: 1989	: 1985-1987
Ordinary nonliquidating dividends of appreciated property.....	3	18	64	114	169	227	196
Investment companies that accumulate earnings.....	--	62	78	33	35	36	173
Expenses incurred with short sales.....	22	32	38	43	48	54	113
Transfers of partnership interests by corporations	--	*	50	50	50	50	100
Foreign corporations:							
Transfers of appreciated property to foreign corporations.....	--	5	55	150	250	350	210
Decontrol of foreign corporations.....	*	*	*	*	*	*	*
Recharacterization of U.S. income as foreign income.....	15	64	68	74	80	86	206
Recharacterization of interest income as dividend income.....	2	6	7	7	8	9	20
Use of territories of avoid U.S. tax.....	2	4	5	5	5	5	14
Source of shipping income.....	5	13	17	18	19	20	48
Foreign collapsible corporations.....	*	*	*	*	*	*	*
Transactions in stock warrants.....	2	3	4	4	4	4	11
Exchange of debt for stock.....	*	*	*	*	*	*	*
Distribution of debt by a corporation--earnings and profits.....	--	*	*	*	*	*	*
Definition of affiliated group of corporations...	--	11	29	48	27	8	88
Net operating loss carryover rules.....	--	--	--	--	--	--	--
Subtotal, corporations.....	51	448	695	846	1,095	1,249	1,989
D. Time value of money and other accounting abuses:							
Deferred payment transactions.....	114	431	868	1,335	1,802	2,287	2,634
Premature accruals.....	303	643	646	603	576	563	1,892
Prepaid expenses.....	123	277	88	106	127	152	471
Deferred like-kind exchanges.....	*	48	268	567	670	716	883
LIFO conformity.....	--	105	185	200	200	200	490
Inclusion of tax benefit items in income.....	--	229	253	274	300	331	756
Below-market-interest and interest-free loans.....	108	126	143	150	158	166	419
Income averaging--140%, 3 year base.....	82	2,019	1,846	2,004	2,180	2,360	5,869
Subtotal, time value of money.....	730	3,878	4,297	5,239	6,013	6,775	13,414
E. Treatment of bonds and other debt instruments:							
Debt obligations acquired at a discount:							
Market discount.....	*	4	16	31	58	79	51
Zero coupon municipal bonds (OID).....	*	1	2	4	6	7	7
Short-term obligations issued at a discount.....	75	218	281	268	154	144	767
Income from factoring trade receivables.....	--	313	549	590	637	689	1,452
Subtotal, debt obligations.....	75	536	848	893	855	919	2,277
P. Compliance provisions.....	--	20	92	175	232	255	287

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Revenue Effect of the Tax Reform Act of 1984 as Passed by the Ways and Means Committee
(March 12, 10:00 a.m.)

(\$millions)

	Fiscal years						Total
	1984	1985	1986	1987	1988	1989	1985-1987
G. Employer-employee benefit items.....	23	146	178	224	274	336	548
H. Other provisions affecting certain tax-motivated transactions:							
Transfers of property between related taxpayers...	--	*	*	*	*	*	*
Collapsible corporations.....	5	57	196	305	351	382	558
Subtotal, other provisions.....	5	57	196	305	351	382	558
I. Tax straddles.....	406	163	82	60	75	90	305
J. Highway taxes:							
Heavy vehicle use tax.....	-232	-550	-618	-675	-583	--	-1,843
Diesel fuel tax.....	86	502	635	644	695	45	1,781
Total, highway taxes.....	-146	-48	17	-31	112	45	-62
K. Miscellaneous provisions:							
PIK.....	-7	-8	15	--	--	--	7
1978 unemployment benefits.....	--	--	--	--	--	--	--
Travel expenses at Nekoma, N.D.....	--	--	--	--	--	--	--
Estate tax installment sales.....	--	-5	-7	-10	-13	-16	-22
Modified tax treatment for RIC's.....	*	*	*	*	*	*	*
Tip income under FUTA.....	--	16	26	28	30	32	70
Luxury cars (\$21,000 base).....	20	54	53	44	45	47	151
Compliance provision, automobile depreciation.....	--	26	63	91	109	120	180
Cooking wine.....	--	--	--	--	--	--	--
Home for handicapped person won as prize.....	--	--	--	--	--	--	--
Investment income from S corporations.....	--	*	*	*	*	*	*
Nonprofit dependent care organizations.....	--	-1	-1	-1	-1	-1	-3
Subtotal, miscellaneous.....	13	82	149	152	170	182	383
Total, additional revenue provisions.....	1,322	7,786	15,562	19,055	17,856	16,235	42,403
Total, Tax Reform Act of 1984.....	1,475	8,557	16,118	20,828	21,158	21,503	45,503

Office of the Secretary of the Treasury
Office of Tax Analysis

March 12, 1984

* Less than \$500,000.

SENATE FINANCE COMMITTEE
TENTATIVE DECISIONS TO DATE

(\$ millions)							
Proposal	Fiscal years						Total
	1984	1985	1986	1987	1988	1989	1987
Reconciliation (S.2062):							
Limit income averaging (140%).....	61	1,404	1,357	1,474	1,603	1,735	4,315
Compliance options.....	-	40	102	175	232	255	317
Phase out corporate graduated rates.....	108	190	206	224	245	266	620
Tax exempt leasing.....	499	1,011	1,848	3,161	5,032	7,097	6,020
Postpone net interest exclusion to 1988.....	-	920	2,874	3,152	2,249	-	6,946
Extend student loan exclusion thru 1984.....	-*	-*	-	-	-	-	-*
Withholding on U.S. real estate gains of foreign persons.....	44	42	10	10	11	14	62
Six month holding period and \$1,000 capital loss limitation.....	*	603	401	380	408	441	1,384
Straddles.....	133	268	52	39	53	65	359
Estimated payments on individual alternative minimum tax....	-	611	45	49	52	56	705
Collapsible corporations.....	5	57	196	305	351	382	558
Sport fishing equipment tax.....	-	12	13	14	14	15	39
Total Reconciliation.....	850	5,238	7,104	8,983	10,250	10,326	21,325
Tax Shelter Provisions:							
Partnership allocations:							
Retroactive allocations.....	-	50	75	100	100	100	225
Limitations on partnership allocations and recharacterizations of certain partnership distributions							
special item allocations.....	4	61	147	178	240	298	386
recharacterization of capital expenditures.....	-	20	51	60	69	78	131
Property contributed by a partnership.....	-	24	63	66	67	69	153
Charitable contributions (arts & humanities).....	-	7	24	26	29	32	57
Like-kind exchanges (6 months).....	-	226	630	667	788	842	1,523
Market discount.....	*	*	*	*	*	*	*
Leveraged purchases of T bills or market discount bonds....	357	363	12	16	22	29	391
Accounting abuses:							
Treatment of interest attributable to							
deferred payments (1/1/85).....	-	228	721	1,253	1,789	2,349	2,202
Prepayment of expenses.....	10	22	7	8	10	12	37
Interest free loans.....	103	126	143	150	158	166	419
Related party transactions - low income housing exception.....	54	109	176	253	346	416	538
LIFO conformity.....	-	105	185	200	200	200	490
Premature accruals - mining and nuclear excluded.....	206	457	460	403	360	329	1,320

(\$ millions)							
Proposal	Fiscal years						Total
	1984	1985	1986	1987	1988	1989	1985-1987
Corporate reforms:							
Dividends:							
Leveraged stock investments by corporations.....	-	90	180	200	200	200	470
Expenses incurred with connection with short sales.....	22	32	38	43	48	54	113
Receipts of extraordinary dividends by corporations.....	-	45	100	100	100	100	245
Transfer of partnership interest by corporations.....	*	50	50	50	50	50	150
Investment companies and mutual funds:							
Widely held corporations and the accumulated earnings tax.....	-	62	78	33	35	36	173
Capital gains distributed from mutual funds.....	-	*	83	89	96	103	172
Taxation of transfer of certain assets of foreign corporations.....	-	5	55	150	250	350	210
Decontrol of CFC's.....	*	*	*	*	*	*	*
Grace Commission Recommendations:							
Repeal tax exemption for Freddie Mac.....	52	84	109	142	185	240	335
EFT of alcohol and tobacco (14 day float; \$5 mil).....	683	8	-159	7	7	7	-144
EFT for pay checks, etc. 1/.....	-	-	-	-	-	-	-
Offset nontax debt with refunds (1/1/86-1/1/88).....	-	-	151	73	-	-	224
Acceleration on nontax receipts.....	-	-	-	-	-	-	-
Improve income verification.....	-	-	-	-	-	-	-
Freeze Items:							
Extend telephone excise.....	-	-	1,168	2,016	803	-	3,184
Expensing - freeze at \$5000 through 1987.....	202	348	366	278	-166	-537	992
ITC for used property.....	-	49	104	115	87	31	268
Exclusion of foreign earned income.....	-	4	11	16	14	5	31
Other tax proposals:							
Six corporate reforms:							
Dividend reporting rules.....	*	*	*	*	*	*	*
Dividends from mutual funds.....	*	*	*	*	*	*	*
Warrants.....	2	3	4	4	4	4	11
Dividends of OID obligations.....	*	*	*	*	*	*	*
Nondivisive "D" reorganization ("control" definition).....	*	*	*	*	*	*	*
Liquidation requirement for "C" reorganizations.....	*	*	*	*	*	*	*
Alternative minimum tax changes.....	-	122	603	560	518	485	1,285

(\$ millions)

Proposal	Fiscal years						Total
							1905-
	1984	1985	1986	1987	1988	1989	1987
Extend Sec. 167(k) (low income housing) thru 1986.....	-2	-7	-18	-32	-43	-34	-57
Reciprocal leases.....	*	*	*	*	*	*	*
Tax benefit rule.....	-	229	253	274	300	331	756
20 year ACRS - nonresidential structures (1/1/85) 2/.....	-	263	1,093	1,888	2,776	3,730	3,249
Limitation on personal use of business property.....	-	20	3	132	303	386	155
Distilled spirits excise tax (outlay).....	-	-	-	-	-	-	-
Section 1231 losses.....	26	72	104	160	220	287	336
Source of shipping income.....	5	13	17	18	19	20	48
Factoring of trade receivables.....	-	313	547	590	637	689	1,450
Recharacterization of US income as foreign income.....	15	64	68	74	80	86	206
Postpone finance lease rules until 1988.....	63	351	875	1,404	1,445	739	2,630
Distribution of appreciated property.....	3	18	64	114	169	227	196
Amortize pre-opening expenditures (5 years).....	-	23	36	31	26	19	90
Multiple trusts.....	-	23	29	27	26	21	79
Trust distributions.....	50	214	361	409	438	467	984
Limit ITC on sound recordings.....	-	5	10	10	10	10	25
PSC with amendments.....	-	-43	-33	36	88	-98	-40
Members bills:							
Nonstatutory fringe benefits (extend thru 12/31/85).....	*	*	*	*	*	*	*
Net operating losses (extend thru 10/31/84).....	-8	-8	-8	-8	-8	-8	-24
Employee education assistance.....	-7	-39	1	22	24	26	-16
Demolition of historic structures.....	*	*	*	*	*	*	*
Architectural and transportation barrier removal.....	-7	-13	-6	-	-	-	-19
Reporting of state tax refunds (timing).....	-2	-21	-22	-16	-17	-19	-59
Estate tax payments.....	-	-5	-7	-10	-12	-15	-22
Rehabilitation tax credit.....	-*	-*	-*	-*	-*	-*	-*
Exemption from excise for certain helicopters.....	-3	-4	-4	-5	-6	-7	-13
Multiemployer pension plan withdrawal liability.....	-*	-*	-*	-*	-*	-*	-*
Rollover to IRA of certain pension distributions.....	-*	-	-	-	-	-	-
FICA and FUTA exemption for certain retirement contributions	-	-	-	-	-	-	-
Tax treatment of regulated investment companies.....	*	*	*	*	*	*	*
Cooperative housing corporations.....	-*	-*	-*	-*	-*	-*	-*
Income tax exemption for military KIA.....	-*	-	-	-	-	-	-
Abatement of penalty (York).....	-*	-	-	-	-	-	-
Estate tax credits (Rabe & Redfield).....	-22	-	-	-	-	-	-

(\$ millions)

Proposal	Fiscal years						Total
	1984	1985	1986	1987	1988	1989	1985-1987
FUTA-treatment of fishermen.....	-*	-*	-	-	-	-	-*
Coordination of foreign personal holding company rules and Subpart F.....	-	1	3	3	3	3	7
State employee pension trust extension of time to comply....	-*	-*	-*	-	-	-	-*
Unemployment compensation for pre-1973 periods.....	-*	-	-	-	-	-	-
PIK.....	-7	-8	15	-	-	-	7
Wildlife refuge system.....	-	-	2	2	5	5	4
Estate and gift tax marital deduction (tech. change).....	-*	-*	-*	-*	-*	-*	-*
AT&T pension portability.....	-	-	-	-	-	-	-
Social Security coverage for congressional employees.....	-	-	-	-	-	-	-
Alimony compensation for IRAs plus spousal tech change.....	-	-1	-1	-1	-1	-1	-2
Tax exempt status of nonprofit dependent care facilities....	-	-1	-1	-1	-1	-1	-3
Extension of Indian tribal tax status act.....	-	-1	-1	-1	-1	-1	-3
Exempt certain waste disposal facilities from IDB limits....	-*	-*	-*	-*	-*	-*	-*
Technicals on tip reporting.....	-	-	-	-	-	-	-
Total except Reconciliation.....	1,804	4,164	9,015	12,376	12,889	12,910	25,555
Grand total.....	2,654	9,402	16,119	21,359	23,139	23,236	46,880

Office of the Secretary of the Treasury
Office of Tax Analysis

March 12, 1984
9:30 am

- 1/ Not a tax proposal - CBO estimate of the net saving to the Treasury is \$1.2 billion in 1985 and less then \$50 million in following years.
2/ Parameters undecided.

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D. C. 20500

MARTIN FELDSTEIN, CHAIRMAN
WILLIAM A. NISKANEN
WILLIAM POOLE

March 13, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: The Pension Policy Working Group **WAN**
SUBJECT: Proposed Policy for the Reversion of Surplus
Assets from Terminated Pension Plans

Background

In recent years, a number of companies have recovered surplus assets from their defined benefit pension plans after terminating the plans and purchasing annuity contracts to provide all accrued benefits. Current law allows such reversions, if certain requirements are satisfied. Some companies have also attempted to recover assets through the use of the "spinoff-termination" technique, by which a plan is divided into two plans, one for retirees, the other for active workers. Surplus assets are allocated to the retirees' plan, which is then terminated, and the plan for the active workers continues without change.

Since 1979 the Pension Benefit Guaranty Corporation has recorded 190 terminations in which the plan sponsor recovered surplus assets of more than \$1 million. Another 52 such cases are pending. The 242 terminated plans covered 298,874 employees, about one percent of the total number of workers covered by PBGC-insured pension plans. Surplus assets totalled \$2.2 billion, about one-third of one percent of the total assets of PBGC-insured pension plans.

The number of plans with surplus assets has increased during the last few years. These surpluses are largely the result of such unforeseen circumstances as the bull market in stock prices and persistently high interest rates (which make it less expensive to purchase annuity contracts to provide participants benefits). In many cases, the surpluses are large relative to plan benefits. For the 242 cases with reversions in excess of \$1 million, the average plan had assets equal to 181 percent of the cost of benefits.

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Many reversions are by-products of terminations that would have occurred in any case because of adverse business conditions, sales of corporate assets or other causes. Where obtaining a reversion is the primary motive for termination, there has been uncertainty concerning the legality of replacing the terminated plan with another defined benefit plan. In some cases, this uncertainty has led to the substitution of a defined contribution plan or no plan at all.

The recent increase in large reversions has drawn criticism on various grounds. The most important of these are --

- Surplus assets often result from fluctuations in the capital markets. Since these markets can go down as well as up, reversions to employers may reduce the security of employees' benefits.
- The availability of reversions makes it possible to use pension plans for deferring or avoiding business taxation.
- Upon termination, a plan can give lump sum payments to certain participants in lieu of future pensions. In some cases, the interest rates used to compute these lump sums are higher than those available to individuals, resulting in decreases in the value of benefits.

Legislative Proposals

1. Some critics of reversions have proposed that terminating plans be required to apply all surplus assets to purchase additional benefits for participants.

The Department of Labor, the PBGC, and the Department of the Treasury oppose any general prohibition against the recovery of surplus assets by an employer. In the past companies have made contributions to defined benefit plans in the good faith belief that surplus assets could be recovered upon plan termination. This belief has made them more amenable to conservative funding standards and has helped to maintain the strength of defined benefit plans. Allowing the recovery of surplus assets is also equitable, because the employer is required to make up any funding deficiencies in the plan.

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The proposals that are set forth in this paper would protect all benefits that employees have earned to the date of plan termination. The compulsory purchase of additional benefits would, on the other hand, result in a transfer of existing property rights from employers to employees. In almost half of the terminations pending before the PBGC, benefits would be at least doubled.

The PBGC is also concerned about the impact that anti-reversion legislation might have on the plan termination insurance system. Projections of the PBGC's future premium requirements assume that the number of plan participants will continue to grow at a rate of about 1.1 million per year. New burdens could discourage the formation of defined benefit plans and lead to higher premiums. If, for example, participant growth were to cease, the currently estimated premium requirement would go up by thirty percent (from \$7.00 to \$9.25 per participant per year).

2. Senator Howard Metzenbaum has proposed a moratorium on the processing of terminations that result in reversions in excess of \$1 million.

All three agencies believe that a moratorium would be disruptive, would penalize companies that are in the middle of legitimate business transactions and would imply disapproval of reversions. The ultimate effect would be to delay, rather than to accelerate, the resolution of such problems as actually exist.

3. Some Congressional sources have suggested that an excise tax be imposed on reversions, which are now taxable as ordinary income. The new tax would be designed either to reclaim the "tax subsidy" enjoyed by investments of qualified pension plans or to prevent offsetting reversion income by the use of net operating losses and other deductions and credits.

It has been suggested that reversions can give rise to two possible "tax abuses". First, a company may deliberately overfund its pension plan, accumulate income tax free, then arrange a reversion. Second, a pattern of frequent terminations and reversions could undermine the minimum funding standards by allowing an employer, in effect, to fund its plan on a termination basis, rather than an ongoing basis.

-4-

The first of these potential abuses does not appear to be a widespread problem (except perhaps in very small plans, where the 1982 tax act was designed to curb abuses and probably does not need to be supplemented). The more general pattern of underfunding suggests that employers seem more eager to minimize than to maximize pension contributions. The deliberate use of a pension plan as a "tax free savings account" entails the diversion of funds from the employer's business. Even where extra cash is available for investment, the advantage of investing via a pension plan does not appear overwhelming.

The second potential abuse can be adequately curbed by the use of tools already available to the Internal Revenue Service. One of the requirements for tax qualification is that a plan be intended to be permanent. Frequent terminations would violate this rule, resulting in disqualification and the loss of the plan's tax benefits.

Administration Considerations

A plan reversion is initiated by an employer and is subject to the approval of several Federal agencies. For an employer, the objective of a reversion is to shift surplus assets from the pension plan to the company balance sheet. An employer has clear title to these surplus assets if it meets the statutory requirements for a plan termination (the full vesting of past service benefits and the purchase of annuity contracts to cover these benefits). An employer may now reduce the surplus pension assets in several ways. The annual contribution may be reduced, permitting the reversion of surplus assets over time. The plan may be terminated with no successor plan. A defined benefit plan may be terminated and replaced with a defined contribution plan. The recent controversy has arisen concerning two other means of reclaiming the surplus assets: A defined benefit plan may be terminated and replaced with a new essentially-similar defined benefit plan with a smaller reserve (the "termination-reestablishment" cases). And a defined benefit plan may be divided into two plans, a continuing plan for the active employees and a new plan for the retired employees that is later terminated in exchange for annuity contracts (the "spinoff-termination" cases). The recent controversy has arisen because current government regulations are not clear concerning these latter two instruments to reclaim surplus assets, although both instruments maintain the benefits of both active and retired employees.

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Three other parties are potentially affected by the several means to reclaim surplus assets -- the employees, the PBGC, and the Treasury. The several Federal agencies have approached the recent issue on plan reversions with two objectives:

- to facilitate the legitimate reversion of surplus assets to the employer without any cost to the other affected parties, and
- to accomplish the necessary changes by regulation, if possible, rather than by legislation.

It is especially important to facilitate the reversion of surplus assets by a means that maintains a defined benefit plan for the active employees, because the other forms of authorized termination (with no successor plan or with a defined contribution plan) are less likely to be consistent with the interests of either the employees or the PBGC. It is especially important to avoid a legislative solution, because of the potential for a de facto transfer of the property rights in the surplus assets from employers to employees.

After extensive investigation and negotiation among the affected agencies, it has been determined that the interests of the employees and of the PBGC can be protected by regulatory changes consistent with current legislation. These changes are described in the following Proposed Joint Statement, reflecting the agreement of the Department of Labor, PBGC, and the Treasury Department. As part of this investigation, two additional options were considered:

1. Some part of the surplus assets could be reserved to provide a "cushion" to increase the security of the benefits of the successor defined benefit plan. The required purchase of annuities for past service benefits, however, is sufficient to protect these benefits, and it was determined that the minimum funding standards of the Internal Revenue Code appear to be sufficient to protect future benefit accruals. A required "cushion", therefore, does not appear to be necessary to protect the interests of the employees and the PBGC and may have the effect of inducing other types of terminations that do not involve a successor defined benefit plan.

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2. A change in the prohibited transactions rules to permit employers to borrow surplus assets or to use these assets as collateral on a loan would provide employers the same cash flow without any formal termination. This option deserves further consideration, but the Department of Labor believes it would be procedurally difficult.

There are two remaining general issues, but neither of these issues are specific to the reversion of surplus assets:

1. Any type of plan termination may reduce the expected future pension benefits of active employees, even though past service benefits are fully protected. This potential problem arises because the benefits under a defined benefit plan are based on the years of service under that plan and the salary during the last few years of service. Any plan termination prior to retirement reduces the years of service on which the pension benefits are based. This potential problem is inherent in any voluntary pension system in which plans may be terminated for any reason. The empirical evidence does not now provide an adequate basis for determining the nature and magnitude of this potential problem.

2. Any type of plan termination may have the effect of deferring or avoiding the taxes on the accumulated surplus in a qualified plan. This creates the potential for a business to use its pension plan as a "tax-free savings account". A concern about such potential tax abuse has led to proposals for an excise tax or some other penalty on all plan reversions. This potential problem is also inherent in any voluntary pension system in which plans may be terminated for any reason. The empirical evidence does not now provide a basis for determining the nature and magnitude of this potential problem. The more general pattern of underfunded plans suggest that the existing tax incentives for overfunding are small relative to other conditions that affect plan funding.

For the reasons described above, the affected agencies decided against addressing these issues as part of the resolution of the issues specific to the reversion of surplus assets.

Recommended Position

The Pension Policy Working Group recommends Cabinet Council approval of the following Proposed Joint Statement as the basis for resolving the issues specific to the reversion of surplus assets. We further recommend that this statement be released to the public to provide guidance about the future treatment of proposed reversions and that all testimony by the Administration be based on the provisions of this Joint Statement.

Proposed Joint Statement
on the
Reversion of Surplus Assets from Pension Plans

In recent months, considerable public and Congressional concern has been expressed over the termination of defined benefit pension plans for the purpose of recovering surplus assets. For various reasons, many plans have more funds on hand than are needed to provide all of the benefits that have been promised to employees.

From October 1979 through February 1984 there have been 242 plan terminations in which the surplus recovered by the plan sponsor exceeded one million dollars. The terminated plans covered approximately 298,000 employees (about one percent of the total number of workers covered by private defined benefit pension plans). The recoveries totalled \$2.2 billion (about one-third of one percent of the total assets of private defined benefit pension plans).

Although the law has long permitted the recovery of surplus assets, certain aspects of these transactions have been criticized. The Treasury Department, the Department of Labor and the Pension Benefit Guaranty Corporation have studied these criticisms and have concluded that steps are needed to prevent abuses in this area. This Joint Statement of Policy addresses the following problems:

1. Upon plan termination, employers can make lump sum payments to participants in lieu of future pension payments. In some cases, these lump sums have been calculated on the basis of discount rates that are higher than those available to individuals, reducing the value of benefits.
2. Surplus assets often result from fluctuations in the capital markets. Since these markets can go down as well as up, an employer's recovery of surplus may leave employees' accrued benefits in a successor plan insufficiently protected against unfavorable market movements.
3. Many plan sponsors are uncertain whether under current government regulations a "spinoff-termination" or a "termination-reestablishment" case can be followed by a plan that maintains active employees' benefits at undiminished levels. This uncertainty encourages the replacement of terminated pension plans with no plan or with other types of

4. Burdensome requirements placed upon defined benefit pension plans may discourage the establishment or maintenance of these plans - and may have the unfortunate effect of driving sponsors away from the defined benefit system.

To address these problems and to clarify the rights of employers and employees, the Treasury Department, the Department of Labor and the Pension Benefit Guaranty Corporation have agreed to a joint policy for dealing with plan terminations in which the employer recovers excess assets. Each agency has taken or will take the steps necessary to implement this policy.

Joint Statemnt of Policy

1. In accordance with current law, when an employer terminates a defined benefit pension plan, it may not recover any surplus assets until it has fully vested all participants' benefits and has purchased annuity contracts to protect participants against the risk that their accrued benefits may be jeopardized by future market fluctuations or other factors.

2. If employees are offered lump sum payments in lieu of future pensions, the amount of the lump sum must fairly reflect the value of the pension. The Pension Benefit Guaranty Corporation is developing guidelines for determining appropriate lump sum values.

3. An employer that terminates a sufficient defined benefit pension plan may establish a new defined benefit plan covering the same group of employees. The new plan may grant past service credit for the period during which an employee was covered by the terminated plan (subject to the limitations of section 415 of the Internal Revenue Code). The prior plan and the new plan, in combination, may provide benefits for each participant equivalent to those to which he would have been entitled if the prior plan had continued without interruption. The PBGC will issue regulations clarifying the fact that a successor plan is exempt from the five year phase-in of benefit guarantees that applies to newly established plans.

4. If an ongoing pension plan is divided into two plans, one of which is terminated shortly thereafter without an independent business reason (a "spinoff-termination), the employer may not recover surplus assets from the terminated plan unless the following conditions are satisfied:

- * The benefits of all employees (including those covered by the ongoing plan) must be fully vested and

nonforfeitable as of the date on which assets and liabilities were transferred.

- * All benefits accrued as of the date of transfer must be provided for by the purchase of annuity contracts.
- * All employees who were covered by the original plan must be given advance notice of the transaction in similar time and maner as if the entire original plan were being terminated.

The new regulations covering the reversion of plan assets will not be applied in reversions less than \$1 million except in cases of abuse of the insurance system. The purpose of this "de minimus" rule is to reduce the regulatory burden on small business and the administrative costs to the PBGC. Some large businesses may be exempted from the new regulations because of the "de minimus" rule, but the purpose of these exempted terminations would not be to recover excess assets. Large firms can recover small amounts of overfunding through reduced funding contributions. The effect of the "de minimus" rule is to eliminate some of the restrictions on spinoff terminations for small business. The PBGC experience indicates that small employers have little incentive to engage in spinoff-terminations to recover excess assets, although these terminations do occur for other reasons. In these cases participants are protected by minimum funding rules and PBGC insurance coverage.

5. Employers are reminded that one of the requirements for plan qualification is that the plan be intended to be permanent. Thus, a persistent pattern of termination ("re-establishment" or "spinoff-terminations") may result in plan disqualification even though the specific guidelines described above are satisfied with regard to each of the transactions.

Statistics Concerning Major Asset Reversions
Table 1
Reversions in Excess of \$1 Million by Year of Termination

	<u>Plans</u>	<u>Participants</u>	<u>Assets</u>	<u>Benefits</u>	<u>Reversions</u>
1979	8	608	\$13.2	\$3.5	\$9.7
1980	5	1,987	12.1	5.0	7.1
1981	24	20,784	236.0	127.4	108.6
1982	68	49,449	554.2	323.5	230.7
1983	83	142,264	2,022.5	1,215.6	806.9
1984 and pending	54	83,782	2,096.6	1,048.1	1,048.5
Total, 1979-1984	242	298,874	\$4,934.6	\$2,723.1	\$2,211.5

Figures for assets, benefits and reversions are in millions.
Source: PBGC Case Processing System.

Table II
Reasons for Termination
Plans with Reversions in Excess of \$1 Million

<u>Reason</u>	<u>Plans</u>	<u>Participants</u>	<u>Reversions</u>
Adverse business conditions	29	38,738	\$197.6
Dissolution of employer	8	3,555	47.2
Closing of employing unit	13	7,779	27.2
Bankruptcy	2	847	3.5
Change of company ownership	46	37,554	248.9
Merger	7	3,404	28.1
Adoption of superseding plan	67	161,985	1,149.2
Impact of ERISA	13	7,053	36.7
Excessive cost of plan	15	10,610	56.3
Other reasons	36	23,662	409.3
No reason given	6	3,106	14.6
Total	242	298,293	\$2,218.6

Dollar figures are in millions.

Total do not agree with Table I because of minor discrepancies in the summaries used to prepare the two tables.

Source: PBGC Case Processing System

Table III
Future Plan Coverage in Cases Pending with PBGC
Reversions in Excess of \$1 Million

<u>Type of Successor Coverage</u>	<u>Plans</u>	<u>Participants</u>	<u>Reversions</u>
Defined Benefit Plan	23	50,497	\$805.9
Defined Contribution Plan	22	25,326	124.0
No successor plan	6	3,691	23.1
Unknown	1	122	1.0
Total	52	79,636	954.0

Dollar figures are in millions.

Source: PBGC Case Processing System and survey of plan sponsors.